REIT REPORT

XYMAX REIT Investment Corporation

3488

Tokyo Stock Exchange REIT

15-Dec.-2022

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Index

Summary

As the REIT of the real estate management major the XYMAX Group, aims to increase the distribution through progressing a growth strategy

1. A major strength is the support it receives from the XYMAX Group, a real estate management major

XYMAX REIT Investment Corporation <3488> (hereafter, also "the REIT") is sponsored by the XYMAX Group, which is centered on the leading real estate management company XYMAX Corporation (not listed), and it is a comprehensive-type REIT that invests in real estate such as offices, retail facilities, and hotels, primarily in Tokyo's 23 wards and surrounding prefectures. The REIT aims to draw-out the value of real estate to the greatest possible extent and to maximize investor value by conducting appropriate portfolio management that utilizes the knowledge and expertise in real estate possessed by its sponsor, the XYMAX Group that has one of the leading track records for real estate management in Japan. All of the actual asset management is consigned to XYMAX REAL ESTATE INVESTMENT ADVISORS Corporation, and a strength is the various types of support it can receive from the XYMAX Group.

2. The FY8/22 results exceeded the initial forecasts, with significant increases in revenue and income

In FY8/22, the Japanese economy showed a trend towards recovery as the novel coronavirus pandemic (hereafter, COVID-19) settled down, the real GDP growth rate increased following a recovery in personal consumption, and also as the lending balance for real estate trended at a high level. In this situation, the REIT's results were strong and greatly exceeded the initial forecasts. Specifically, operating revenue was ¥1,874mn (up 16.3% compared to the previous fiscal period) and operating income was ¥1,121mn (up 18.5%), so both revenue and income increased significantly, with operating revenue exceeding the initial forecast by 2.7% and operating income exceeding it by 3.2%. In March 2022, the REIT conducted a capital increase through a public offering, the first since it was listed, and expanded its portfolio to 18 properties with a value of ¥43.4bn (acquisition price basis), which contributed significantly to higher revenue and income. In addition, management of its properties delivered solid returns, providing driving force for higher revenue and income. Breaking down the portfolio by usage, offices maintained high occupancy rates through stable operations, while retail facilities recorded stable earnings based on fixed rent contracts. Meanwhile hotels, which had experienced a slump in operating results also reported their highest performance during the COVID-19 pandemic with the generation of variable rent. Based on an increase in the number of investment units associated with the favorable financial results and public offering, the distribution was ¥4,019 per unit (up ¥123 from the previous fiscal period), exceeding the initial forecast by ¥152. Looking at the financial position at the end of FY8/22, Total assets' LTV* (hereinafter, LTV) was low at 41.0%, and there is plenty of room for further borrowing up to 50%. The REIT is also building a wide and stable lender formation, mainly comprised of megabanks and regional banks and in June 2022 acquired an A- issuer rating from R&I, all of which will enable it to acquire properties flexibly in the future.

* Total assets' LTV: balance of interest-bearing debt ÷ total assets

3. The FY2/23 and FY8/23 forecasts are based on conservative assumptions

The REIT is forecasting lower revenue and income for the FY2/23 results of operating revenue of ¥1,635mn (down 12.8% compared to the previous fiscal period) and operating income of ¥888mn (down 20.8%). This mainly reflects the absence of a gain on sale of real estate recorded in the previous fiscal period. In addition, the forecast reflects an impact from a decrease in variable rent due to a change in the calculation method for variable rent of hotels, but this is expected to gradually increase from FY8/23 onward. For FY8/23, the REIT is forecasting approximately level results at operating revenue of ¥1,646mn (up 0.7% from the previous fiscal period), operating income of ¥852mn (down 4.0%). Based on the above results forecast, the distribution forecasts are ¥3,120 per unit in FY2/23 (down ¥899 compared to the previous fiscal period), and ¥3,058 per unit in FY8/23 (down ¥62). However, at FISCO we think these forecasts are conservative, the same as the for the previous period's results.

4. Aims to improve investor value through external growth from offices, retail facilities, etc.

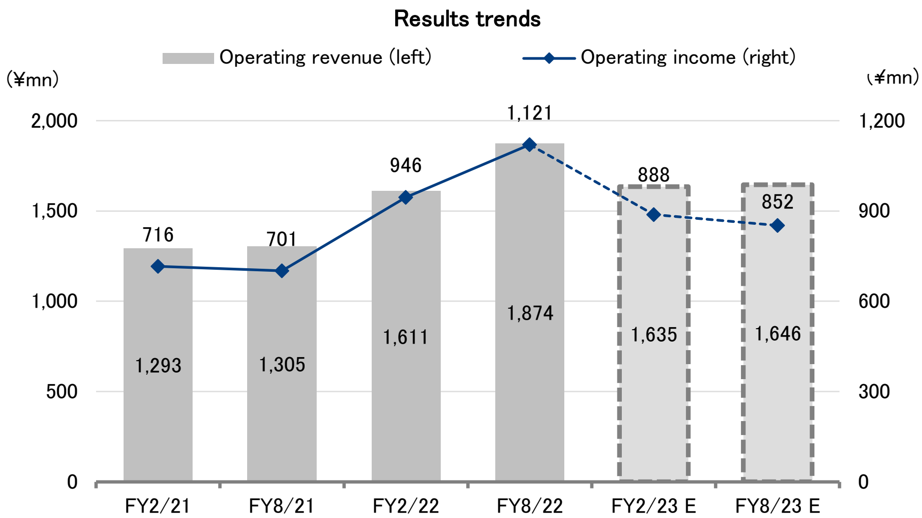
As the external growth strategy for the future, based on the sponsor-support contract, the REIT ascertains needs for sales of real estate it can acquire from the XYMAX Group's customer base, which it aims to lead to opportunities for it to acquire properties. In the office growth strategy, its policy is to acquire properties that are mainly located in Tokyo's eight central wards and the central areas of Nagoya, Osaka, and Fukuoka; that are near to stations within a range of around five minutes' walk from the nearest station; that have a rent unit price per tsubo (a Japanese unit of area equal to approximately 3.31 sq. meters) in a range of ¥10,000 to ¥20,000; and that satisfy a wide variety of renters' needs. For retail facilities, the plan is to acquire properties with a focus on those whose tenant rent revenue is stable and whose property prices are inexpensive. For hotels, it plans to acquire properties located in areas that have excellent access to transport hubs and in areas where the number of overseas visitors to Japan is expected to increase. However, at the current time recovering earnings can be said to be the top priority issue. Also, a notable feature of the REIT is that it is actively working on ESG initiatives, including acquiring environmental certification and implementing environmental and energy-saving measures and promoting the efficient use of energy in the properties it owns

5. Alongside the strengthening of external growth, investors' evaluation is expected to improve

Since entering 2022, the price of the REIT's investment unit has performed well, rising more than the rise of the Tokyo Stock Exchange (TSE) REIT index. It seems the fact that the forecasts for the FY2/22 and FY8/22 distributions were significantly upwardly revised above the initial forecasts gave a favorable impression. Conversely, the issues facing the REIT include that its market capitalization is small and liquidity is low. As of October 28, 2022, the REIT's NAV multiple (price of the investment unit / NAV per unit) was 0.85 times, which is below the average of comprehensive-type REITs of 0.98 times, so the strong sense of it being undervalued continues. Also, its distribution yield of 5.06% is greatly higher than the average of 4.36%. The REIT's policy is to continue to strengthen its external growth strategy in the future and at FISCO, we think that alongside the deepening of investors' understanding, the REIT will attract attention for providing a distribution yield at an appealing level

Key Points

- A comprehensive-type REIT that invests in offices, retail facilities, hotels, etc., mainly in Tokyo's 23 wards and surrounding prefectures, and a major strength is the support it receives from the XYMAX Group
- In FY8/22, revenue and income were greatly higher than the initial forecasts with significant contribution from solid performance in operation of properties owned by XYMAX REIT. A gain on sale following an asset replacement had a significant impact. The distribution of ¥4,019 per unit was also higher than the initial forecast. LTV is low, so it will be able to acquire properties flexibly in the future
- Is forecasting that revenue and income will decrease in FY2/23 due to the impact of the absence of a gain on sale of real estate, with operating results remaining approximately level in FY8/23. The forecasts are for the distribution to decrease to ¥3,120 per unit in FY2/23 and to ¥3,058 per unit in FY8/23. However, these forecasts appear to be based on conservative assumptions, the same as previously.
- As the external growth strategies, for offices it acquires properties in the major metropolitan areas that are near stations, with inexpensive rent, and that satisfy a wide variety of renters' needs. For retail facilities, it acquires properties with stable tenant rent revenue and inexpensive property prices. For hotels, it aims to acquire properties with excellent transport access and for which overseas visitors to Japan are expected to increase. But at the current time, it is prioritizing recovering earnings. It also actively conducts initiatives for ESG.
- The recent performance of the investment unit price, increasing significantly and exceeding the market average, has given a favorable impression but it has still not been properly evaluated compared to the comprehensive type REIT average. However, alongside the increase in investor understanding of its policy of strengthening its external growth strategy, it seems that the REIT will attract attention for providing an appealing distribution yield.



Source: Prepared by FISCO from the REIT's financial results

Features and competitive advantages

Utilizes the XYMAX Group's knowledge and expertise to the greatest possible extent

1. The REIT's framework

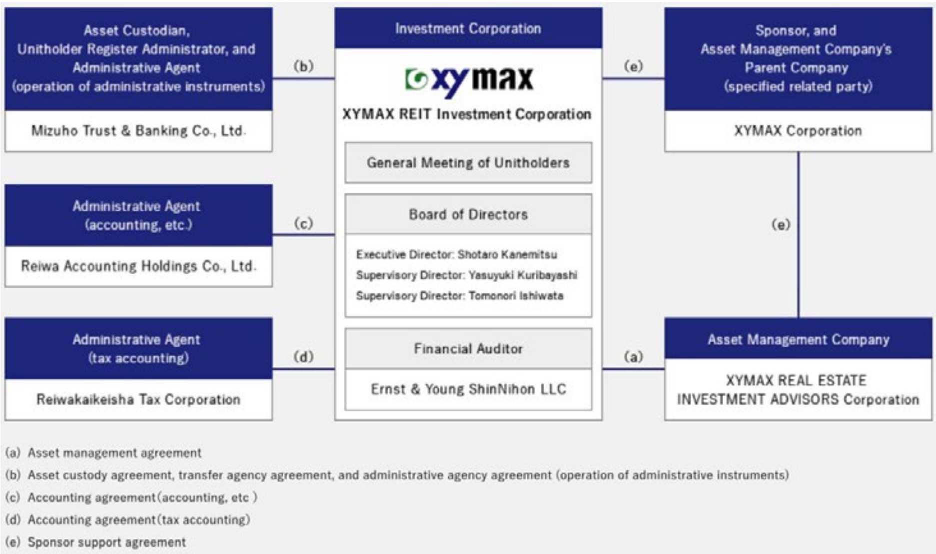
The REIT is a member of the XYMAX Group, which is centered on XYMAX Corporation (not listed), and it is a comprehensive-type REIT that invests in real estate such as offices, retail facilities, and hotels, primarily in Tokyo's 23 wards and surrounding prefectures. It was established in September 2017 and then listed on the Tokyo Stock Exchange's Real Estate Investment Trust (J-REIT) market in February 2018. Its basic philosophy is to aim to draw out the value of real estate to the greatest possible extent and to maximize investor value by appropriate portfolio management that utilizes the knowledge and expertise in real estate possessed by the XYMAX Group.

The XYMAX Group's name is derived from the aim of "maximizing the relationship between the unknown number of X (customers) and Y (the Group)." The XYMAX Group conducts businesses including an office property management business, a retail property management business, an asset management business, and a hotels-related business, and its features are as follows. First, it has "Japan's prominent real estate management record." Specifically, based on recent data, its track record of consignments of real estate management are 1,070 buildings with a total floor area of approximately 5.8mn tsubo, and its track records of consignments from J-REIT other than the REIT is 27 companies and 190 properties. For human resources also, it is building a structure comprised of 2,299 real estate management personnel, 56 leasing personnel, and 64 CRE (corporate real estate) sales personnel. Next, it conducts "real estate management utilizing accumulated various data and development of new businesses applying expertise and know-how." In other words, it conducts real estate management that utilizes its abundant stock of real estate data, of completed contract rent revenue data on 40,807 buildings and 134,677 cases, asking rent data on 58,619 buildings and 19,239 cases, and construction work data on 163,895 buildings. It also utilizes the knowledge and expertise it has accumulated through real estate management to develop new businesses, including the ZXY membership satellite office business and Karaksa Hotels, which is its own hotel brand business. Moreover, it has "a track record of real estate sales and mediation that utilizes its strong customer base." Its real estate owner relations have reached approximately 370 companies, and its track record of real estate sales and mediation is 374 buildings with a total value of approximately ¥588.8bn (cumulative total from April 1, 2010, to March 31, 2022).

In such ways, the XYMAX Group is one of the leading real estate management groups. In real estate investment, which is generally said to be middle-risk middle-return, it is considered that the real estate management capabilities possessed by the Group are essential in order to stably acquire earnings in the medium- to long-term.

The REIT aims to draw-out to the greatest possible extent the value of real estate and to maximize investor value through appropriate portfolio management that utilizes the real estate knowledge and expertise of its sponsor, the XYMAX Group. All of the actual asset management is consigned to XYMAX REAL ESTATE INVESTMENT ADVISORS, and a strength is the various types of support it can receive from the Group. By maximizing this kind of support, the REIT promotes a strategy for steady growth.

The REIT's framework



Source: Reprinted from the REIT's website

2. The REIT's strengths

The REIT aims to maximize investor value by utilizing the knowledge and expertise of its sponsor, the XYMAX Group, in terms of the following "3 strengths."

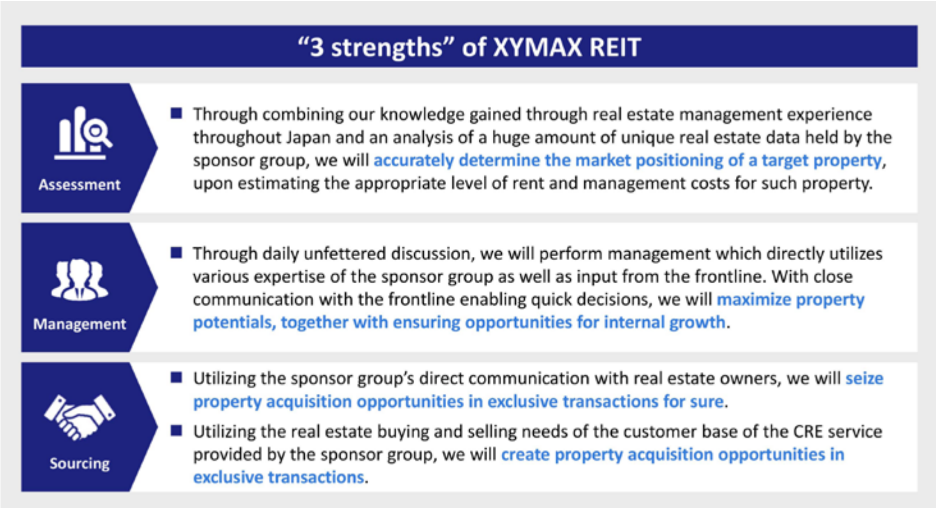
The first is "assessment." By combining the knowledge gained through real estate management experience throughout Japan and an analysis of a huge amount of unique real estate data held by the sponsor group, the REIT accurately determines the market positioning of a target property, upon estimating the appropriate level of rent and management costs for such property.

Second is "management." Through daily unfettered discussion, the REIT can perform management which directly utilizes various expertise of the sponsor group as well as input from the frontline. With close communication with the frontline enabling quick decisions, the REIT maximizes property potentials, together with ensuring opportunities for internal growth.

Third is "sourcing." Utilizing the sponsor group's direct communication with real estate owners, the REIT can securely seize property acquisition opportunities in exclusive transactions. In addition, by utilizing the real estate buying and selling needs of the customer base of the CRE service provided by the sponsor group, the REIT can create property acquisition opportunities in exclusive transactions.

By fully wielding these "three strengths," it appears that the REIT will continuously realize steady growth and achieve initiatives that help make continuous improvements to investor value.

The REIT's strengths



Source: The REIT's results briefing materials

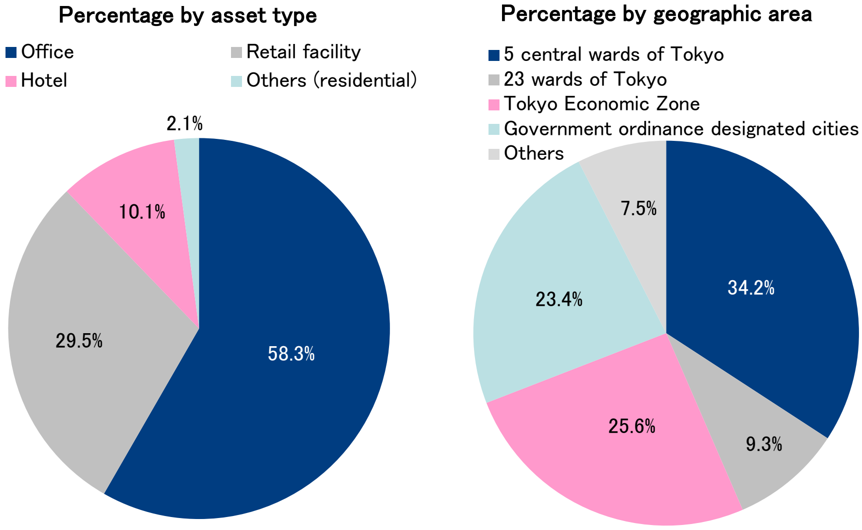
3. Portfolio

According to usage, the REIT invests mainly in offices, retail facilities, and hotels, and also according to geographic area, it concentrates investments in metropolitan areas, particularly Tokyo, and in ordinance-designated cities. The stable occupancy rates through strategically diversifying the portfolio have become the source of earnings.

As of August 31, 2022, the breakdown of the REIT's portfolio by usage (based on acquisition prices) was 58.3% for offices (10 buildings), 29.5% for retail facilities (6 buildings), 10.1% for hotels (1 building), and 2.1% for others (residential, 1 building). Also, the breakdown by geographic area was 34.2% for Tokyo's 5 central wards (Chiyoda Ward, Chuo Ward, Minato Ward, Shinjuku Ward, and Shibuya Ward), 9.3% for the rest of Tokyo's 23 wards, 25.6% for the Tokyo Economic Zone (Metropolitan Tokyo other than the 23 wards, Kanagawa Prefecture, Saitama Prefecture, and Chiba Prefecture), 23.4% for ordinance-designated cities, and 7.5% for others.

In this way, the REIT has invested 97.9% in offices, retail facilities, and hotels that it has positioned as its main assets. It has also invested 69.1% in the Tokyo area (the Tokyo's 23 wards and the Tokyo Economic Zone). For offices, 81.0% are within a three minutes' walk from the nearest station and for retail facilities, 60.3% are next to a station, and in such ways, it also sufficiently considers the location. It can be said to be building a portfolio able to pursue both profitability and stability by investing with a good balance of usage for properties in excellent locations in which are concentrated people and companies.

Portfolio distribution conditions (as of August 31, 2022)



Source: Prepared by FISCO from the REIT's financial briefing materials

Results trends

FY8/22 results were favorable, with revenue and income increasing greatly and significantly higher than the initial forecasts

1. Overview of business performance for FY8/22

The REIT's FY8/22 results were favorable, exceeding the initial forecast as Japan's economy appeared to be on a recovery trend due to an increase in the real GDP growth rate, partly driven by a settling down of the COVID-19 pandemic and recovery in private consumption, as well as the lending balance of real estate trending at a high level. Operating revenue was ¥1,874mn (up 16.3% compared to the previous fiscal period), operating income was ¥1,121mn (up 18.5%), ordinary income was ¥1,004mn (up 15.3%), and net income was ¥1,003mn (up 15.3%), so revenue and income increased greatly, with operating revenue exceeding the initial forecast by 2.7%, operating income exceeding it by 3.2%, and ordinary income and net income each exceeding it by 3.9%.

In March 2022, the REIT conducted its first capital increase through a public offering since it was listed, expanding its portfolio to 18 properties, including four new properties in Kachigawa, Sapporo, Kiba, and Nishikasai, with a value of ¥43.4bn (acquisition price basis). Moreover, hotels generated variable rent. Mainly as a result of these factors, leasing business revenue expanded to ¥1,523mn (up 18.2% compared to the previous fiscal period) and leasing business income to ¥1,091mn (up 21.1%), contributing significantly to the increase in revenue and income. Also, net income is nearly at the same level as ordinary income because the REIT is exempt from corporation tax when paying a distribution of more than 90% of net income before taxes.

The REIT conducts steady management that utilizes the XYMAX Group's network, findings, and expertise, and solid operation of its properties has been the driving force for increased revenue and income. By asset type, offices maintained high occupancy rates through stable operations, and at the end of the period, the contract occupancy rate and the economic occupancy rate, which takes account of free rent, were both 99.2%. Retail facilities maintained 100% occupancy and recorded stable earnings based on fixed rent contracts. In spaces where tenant replacement occurred, contracts were concluded with no downtime at a 15% increase in rent compared to the previous tenants. Meanwhile hotels, reported their highest performance during the COVID-19 pandemic with the generation of ¥25mn in variable rent.

As a result of the above, the REIT conducted a distribution per unit of ¥4,019 (up ¥123 compared to the previous fiscal period) including a distribution in excess of earnings per unit of ¥12 related to allowance for temporary difference adjustment, an increase in distribution that exceeded the initial forecast by ¥152. The occupancy rate for the portfolio as a whole as of August 31, 2022 was 99.7%, maintaining a high level albeit with a decrease of 0.2pt compared to the previous fiscal period. Also, NOI yield (also referred to as actual yield, calculated as actual rent revenue / acquisition price converted into a yearly rate) was 5.7%, maintaining a high rate with a rise of 0.2pt from the previous fiscal period.

Results for FY8/22 (9th FP)

(¥mn)

	FY2/22 Actual Results	FY8/22 Actual Results	Change compared to previous fiscal period		FY8/22 The latest forecast	Compared to the most recent forecast	
			Amount	%		Amount	%
Operating revenue	1,611	1,874	262	16.3%	1,825	49	2.7%
Operating income	946	1,121	175	18.5%	1,086	35	3.2%
Ordinary income	871	1,004	133	15.3%	966	38	3.9%
Net income	870	1,003	133	15.3%	965	38	3.9%
Net income per unit (yen)	3,895	4,022	127	3.3%	-	-	-
Distribution per unit (yen)	3,896	4,019	123	3.2%	3,867	152	3.9%
Occupancy rates	99.9%	99.7%	-0.2pt	-	-	-	-
NOI yield	5.5%	5.7%	+0.2pt	-	-	-	-
Number of issued investment units	223,400	249,650	26,250	-	-	-	-

Note: The most recent forecasts are the initial forecasts announced on April 13, 2022. The FY2/22 occupancy rate and the NOI yield are the values on March 31, 2022.
Source: Prepared by FISCO from the REIT's financial results summary report and financial briefing materials

2. Financial Position

The financial position at the end of FY8/22 was total assets of ¥48,669mn (up 18.0% from the end of the previous fiscal period), net assets of ¥26,440mn (up 12.7%), and interest-bearing debt of ¥19,945mn (up 27.0%). Furthermore, the average procurement interest rate as of August 31, 2022 was 0.632%, the fixed interest rate ratio was 96.5%, and the average remaining borrowing period was 2 years and five months.

The REIT conducted its first capital increase through public offering since listing on March 1, 2022 and conducted a third-party allocation on March 28, 2022, in order to allocate some of these funds to the funds to acquire assets. As a result, the total investment amount increased from ¥22,585mn to ¥25,440mn, and the total number of issued investment units increased from 223,400 to 249,650 units. The issuance of new investment units and sale of investment units can be said to be the result of the steps taken by the REIT to prepare to respond quickly to changes to the financing situation in the future.

Also, as for the parties it borrows from, the REIT has constructed a stable lender platform centered on megabanks and regional banks that have financial-transaction relations with its sponsor. The number of financial institutions participating in this platform has reached 16. Moreover, LTV is low at 41.0% and the REIT has plenty of room for further borrowing up to the target of 50%, meaning it will be able to acquire properties flexibly in the future through additional borrowing. Furthermore, on June 27, 2022 the REIT acquired an issuer rating from R&I of A- (new), so that the direction of the rating has become stable. The acquisition of the rating is likely to contribute to widening the pool of investors and diversifying the means of fund procurement going forward.

FY8/22 (9th FP) financial position

(¥mn)

	FY2/22 Actual results	FY8/22 Actual results	Change compared to previous fiscal period	
			Amount	%
Total assets	41,249	48,669	7,420	18.0%
Net assets	23,456	26,440	2,984	12.7%
Non-operating expenses	15,700	19,945	4,245	27.0%
Average procurement interest rate	0.632%	0.632%	0.0pt	-
Fixed rate ratio	96.5%	96.5%	0.0pt	-
Average remaining borrowing period	2 years and 10 months	2 years and 5 months	-5 months	-
LTV	41.0%	41.0%	0.0pt	-

Note: The below data on the average procurement interest rate in FY2/22 was as of March 31, 2022
Source: Prepared by FISCO from the REIT's financial results summary report and financial briefing materials

Outlook

The FY2/23 and FY8/23 forecasts are based on conservative assumptions

● FY2/23 and FY8/23 results forecasts

For the FY2/23 (10th FP) results, the REIT is forecasting decreases in revenue and income with operating revenue of ¥1,635mn (down 12.8% compared to the previous fiscal period), operating income of ¥888mn (down 20.8%), ordinary income of ¥779mn (down 22.3%), and net income of ¥778mn (down 22.4%). This mainly reflects a fallback due to the absence of a ¥226mn gain on sale of real estate recorded in the previous fiscal period, along with the impact of a decrease in variable rent due to a change in the calculation method for variable rent of hotels. In line with the decrease in hotel rent revenue, mainstay leasing business revenue is forecast to be ¥1,492mn (down 2.0%), and leasing business income is forecast to be ¥1,046mn (down 4.1%). In addition, in FY8/23 (11th FP), operating results are forecast to be approximately level, with operating revenue of ¥1,646mn (up 0.7%), operating income of ¥852mn (down 4.0%), ordinary income of ¥764mn (down 2.0%), and net income of ¥763mn (down 2.0%). Variable rent of hotels is expected to increase gradually from FY8/23 onward, with a small increase in leasing business revenue of ¥1,498mn (up 0.4%) expected. However, since fixed property tax will be levied from FY8/23 on one property acquired in January 2022 and three properties acquired in FY8/22, increasing leasing business expenses, leasing business income is expected to be only ¥1,018mn (down 2.7%).

Based on the above results forecast, the distribution forecasts are ¥3,120 per unit in FY2/23 (down ¥899 compared to the previous fiscal period) and ¥3,058 per unit in FY8/23 (down ¥62). However, at FISCO, we think that the REIT's initial results forecasts are based on conservative assumptions, the same as previously.

FY2/23 (10th FP) / FY8/23 (11th FP) earnings forecasts

(¥mn)

	FY8/22 Actual results	FY2/23 Forecast	Change compared to previous fiscal period		FY8/23 Forecast	Change compared to previous fiscal period	
			Amount	%		Amount	%
Operating revenue	1,874	1,635	-239	-12.8%	1,646	11	0.7%
Operating income	1,121	888	-233	-20.8%	852	-35	-4.0%
Ordinary income	1,004	779	-224	-22.3%	764	-15	-2.0%
Net income	1,003	778	-224	-22.4%	763	-15	-2.0%
Distribution per unit (yen)	4,019	3,120	-899	-22.4%	3,058	-62	-2.0%

Source: Prepared by FISCO from the REIT's financial results summary report and financial briefing materials

Growth Strategy

Aims to improve investor value by improving cruise DPU through external growth centered on offices, retail facilities, etc.

1. Future management growth strategy

The REIT's management growth strategies for FY2/23 (10th FP) and FY8/23 (11th FP) are to realize internal growth, which has continued since it was listed, and also to realize external growth in order to continue to grow at a speed faster than ever before and to further improve investor value through improvement of ordinary distribution per unit (DPU).

As the internal growth strategy for the fiscal period from FY8/18 (1st FP) to FY8/20 (5th FP), for offices and retail facilities, it utilized to the greatest possible extent the XYMAX Group's management capabilities and realized steady internal growth through capturing the opportunities provided by the excellent rental market. From FY2/21 (6th FP), the offices' occupancy rate temporarily weakened due to the impact of COVID-19, but both the occupancy rate and profitability have quickly recovered. Hotels were also greatly impacted by COVID-19, but stable earnings have been recovering since FY2/22 (8th FP). Going forward, it is aiming for the stable management of offices and retail facilities that maintain high occupancy rates. For hotels, it seems that variable rent can be expected to be generated due to the recovery of sales.

Also, as the external growth strategy from FY2/21 (6th FP) to FY8/21 (7th FP), by utilizing a low LTV, the REIT conducted external growth with borrowing as the source of funds. In FY2/22 (8th FP), it returned unrealized gains to investors through asset replacement, and then in FY8/22 (9th FP), it expanded the asset scale through a capital increase by a public offering. In the future also, it will continuously investigate returning unrealized gains to investors through strategic replacement of assets.

In addition to these growth strategies, the REIT is strengthening initiatives for ESG and going forward, it intends to expand its investor base and to diversify fundraising methods by certification for GRESB (a system founded in 2009, centered on the major European pension groups, to evaluate the consideration given to ESG by real estate companies and funds).

The growth strategy by portfolio usage is as follows.

2. Office growth strategy

For the REIT, offices constitute the largest asset in its portfolio and is the business it will focus on going forward.

According to analysis by the XYMAX REAL ESTATE INSTITUTE Corporation, in the office market environment, remote working has increased due to COVID-19, but the disadvantages of it have also been seen, including difficulties in communication and in conducting management, such as for operations and evaluations. In this situation, it seems that the function of offices as places to gather people and functions are being reconfirmed. Moreover, in terms of the rate of employees attending the office after the COVID-19 pandemic has settled down (the post-COVID-19 period), the percentage of companies in the 50% range is the highest, but for SMEs, in contrast to large-scale companies, the percentage considering 100% office attendance is growing.

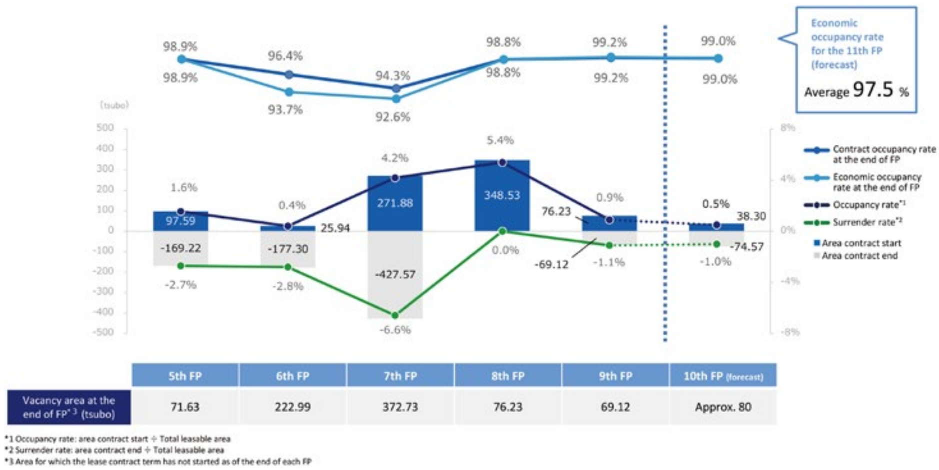
On analyzing the distribution of the number of completed office rental contracts in Tokyo's 23 wards in the rental market from the past until the present time, we see that there are strong tenant needs for a unit price per tsubo in a range of around ¥10,000 to ¥20,000, and also that the vacancy rates of properties within a five minutes' walk from the nearest train station are low compared to properties that are more than five minutes' away. Conversely, the supply of new medium- and small-scale office buildings is limited, and it is thought that this scarcity will increase in the future. Looking at the trend in newly contracted rent according to office scale, compared to large-scale buildings, the rental-revenue volatility of medium- and small-scale buildings is low, indicating that they generate highly stable earnings.

Currently, spurred-on by COVID-19, the REIT is seeing an acceleration of the diversification of offices. In other words, there are differences in the plans for employees to work at the office in the future depending on each company's scale and industry. Moreover, among companies that are advancing the diversification of workplaces, the elements that make-up each workplace are also diversifying. The main offices are becoming bases serving as "gathering places" for employees and are required to be in highly convenient places for employees to gather (city centers), to have safe-building performance (seismic performance and security performance) and to have good building conditions in terms of cleaning and hygiene, and maintenance management. Conversely, offices other than the main offices are "touchdown" bases (places where an environment has been established in which users from other offices can come and work) and bases to work near one's home, and it is considered that they must be in locations near the homes of people who visit the office and employees, and to have features such as a high security performance and an internet environment (a safe Wi-Fi environment).

In such ways, the diversification of workplaces is accelerating, spurred-on by COVID-19. But it is considered that the offices owned by the REIT whose strengths include "excellent locations" and "high-quality management" will have a competitive advantage in the post-COVID-19 period. In our view at FISCO, the REIT has established a competitive advantage in that it can ascertain trends in "ways of using real estate" and companies' office strategies through having a real estate management business and the ZXY business, and also through utilizing the Group's knowledge and expertise cultivated through the surveys and research carried out by the XYMAX Real Estate Institute.

In fact, on looking at the trend in the average occupancy rates of the offices owned by the REIT, while the occupancy rates of offices owned by other J-REITs declined after the 2007-2008 global financial crisis, the offices owned by the REIT have consistently maintained high occupancy rates. In FY8/21 (7th FP), telecommuting increased due to the COVID-19 pandemic, and the REIT's occupancy rate temporarily declined due to some tenants withdrawing. However, in FY2/22 (8th FP) the occupancy rate recovered to 98.8% by steadily filling vacant lots with no new tenant withdrawals, and in FY8/22 (9th FP) the rate has risen to 99.2%. For FY2/23 (10th FP), the rate is forecast to remain at a high level of 99.0%, and with the operation capability of the sponsor group, the forecast is for a steady trend towards stable operations going forward.

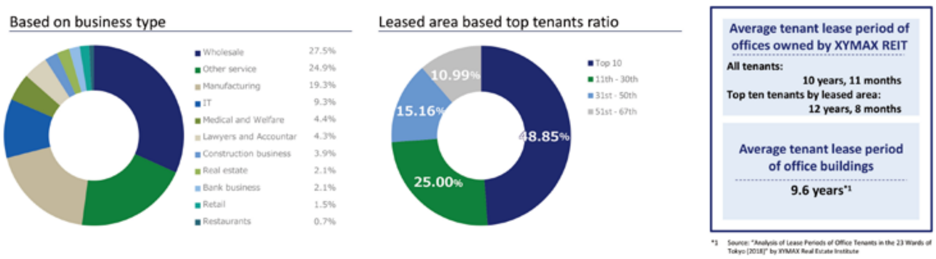
Status of office occupancy rate and tenant withdrawals
(office properties (excluding obligated residences)



Note: Target area for 9th FP: 8,212.46 tsubo
Source: The REIT's results briefing materials

As of August 31, 2022, the REIT owned 10 office buildings that constituted 58.3% of the total portfolio on an acquisition- price basis. Looking at the distribution of the 80 tenants after excluding obligated residences (for businesses that build and develop offices buildings and other buildings above a certain scale, multiple-dwelling residential buildings with a certain number of required units or more depending on the development), there is little bias toward a specific industry among the tenants. Also, the leasing period of the top 10 companies in terms of rented floor space has reached 12 years and 8 months, which is higher than the average for all the tenants of the offices owned by the REIT of 10 years 11 months, and also higher than the average leasing period for the buildings in Tokyo's 23 wards announced in the Analysis of Lease Periods of Office Tenants in the 23 Wards of Tokyo (2018) by the XYMAX Real Estate Institute, of 9.6 years. This shows that the REIT's tenants are highly attached to their properties and are also highly satisfied with the quality of its management.

Office tenant diversification (as of August 31, 2022; 80 office tenants; based on rent revenue)



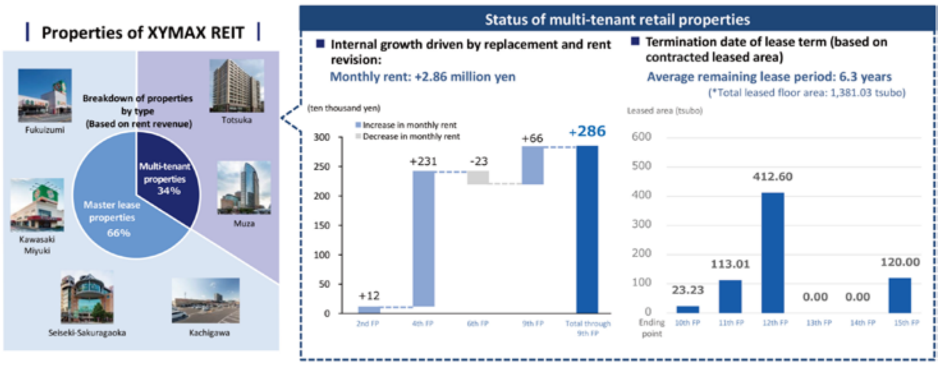
Source: The REIT's results briefing materials

3. Retail facilities growth strategy

According to an analysis by the XYMAX REAL ESTATE INSTITUTE Corporation, the impact of COVID-19 on the retail facilities market as a whole has been limited, but changes can be seen to store-opening strategies alongside consumers' changing needs. In terms of the desire to open restaurants in the food/drink industry, "open only in excellent properties" is 80%, which is greatly above the overall average, and an increasing percentage of companies in the retail and food and drink industries are prioritizing residential areas as their store-opening areas. It is considered that store-openings strategies are being reviewed in the retail and food/drink industries to reflect consumer needs, while in the commercial sector as a whole, although the increase is only slight, is seems that the store-opening desire is recovering.

In this sort of environment, the impact of COVID-19 on the six retail facilities that the REIT owns has been extremely small, and it is stably acquiring rent revenue based on fixed rent contracts. Among the REIT's properties, the four single tenant properties rented to stores that rent that entire building and to master lease businesses provide 66% of rent revenue, and the two multi-tenant-type retail facilities provide 34%. All the retail facilities it owns are located in the suburbs of metropolitan areas where tenant business conditions are expected to be solid in the future. Among the tenants opening stores in master lease properties, the majority have a daily-use business format with strong sales. In the multi-tenant-type retail facilities, the REIT is utilizing the XYMAX Group's findings and expertise to realize internal growth, and monthly rent increased to a cumulative total of ¥286mn for the FY2/19 to FY8/22 period through replacement of tenants and revisions to rent prices with an average remaining rental period of 6.3 years. Even during the COVID-19 pandemic, there have been no tenant bankruptcies or delinquent rent payments. Alongside the changes in the ways of using retail facilities, the REIT is aiming to maintain and improve asset value by investigating a wide range of industries without being restricted to existing industries when leasing properties.

The REIT's retail facilities



Source: The REIT's results briefing materials

4. Growth strategy in the hotel business

In the hotel business, the REIT owns only one property, Hotel Vista Sendai, which is in an excellent location with only a four minutes' walk from JR Sendai Station. However, it has been greatly impacted by COVID-19, and it is the business field that has been suffering the most during the pandemic.

In September 2020, against the backdrop of the "evaporation" of demand, the REIT received a request for a rent exemption from the operator (a management consignment company), and in January 2021, they agreed to change the rent conditions. In March 2021, the operator petitioned the Tokyo District Court to begin civil rehabilitation proceedings, and in October 2021, the civil rehabilitation proceedings were completed and the new sponsor became the parent company. This hotel is a property in an excellent location that generates earnings, so the operator applied to continue with the rental contract, and the plan is to continue with the same contract conditions that were agreed in January 2021 in the future also.

The details of the revised rental contract conditions are as follows. Up to August 2021 in consideration of COVID-19, the REIT adopted a completely variable rent system linked to monthly GOP (Gross Operating Profit) as the rental condition. However, the fixed rent system of ¥20mn per month will be reinstated from September 2021, and also a system will be adopted to enable variable rent to be received when GOP exceeds a certain amount. Moreover, from September 2022, the fixed monthly rent will increase by ¥0.5mn and the REIT is aiming to recover the amount lost up to the previous period due to the exemption within the period of the completely variable rent system. Furthermore, the calculation method for variable rent was changed, returning from the "(Monthly GOP - ¥21mn) × α%" used up to FY8/22 to the pre-COVID-19 method of "(past 1 year's GOP/12 - ¥21.5mn) × α%" (in the case of either method, a negative result is taken as ¥0). Hotel users fluctuate depending on the month, however by basing the calculation after the change on average GOP per month for one year, the REIT can receive stable monthly rent throughout the year. However, for the year of FY2/23 (10th FP) and FY8/23 (11th FP), the REIT expects to receive variable rent revenue predicated on a decrease in sales of approximately 10% and increase in expenses of approximately 3% compared to 2019 prior to COVID-19, so it has set cautious forecasts. Among the facilities managed by operators, Hotel Vista Sendai ranks at the top for performance and for the future as well, it has been positioned as one of the most important bases for operator management, and it is continuing to pay rent as scheduled.

Looking at how the results of Hotel Vista Sendai have trended, in FY2/21, following the Japanese government's declaration of a state of emergency due to COVID-19, RevPAR (Revenue Per Available Room: the average unit price for all rooms available for sales) was recovering. The government issued the fourth declaration of a state of emergency in the second half of July 2021 due to the increase in the number of infected people, but no significant drop was seen in the results of the hotels for FY8/21 to the same extent as when the first and second declarations were issued. Continuing in FY2/22, priority measures, including quasi-state of emergency COVID-19 measures, were implemented. But even so, RevPAR, improved compared to the previous fiscal period and signs of further recovery were seen in FY8/22, so we can expect it to recover to pre-COVID-levels going forward. It seems that in the background to this is that among people, awareness has spread of the ways to respond to COVID-19 in order to prevent infections. At the present time, the emergency COVID-19 priority measures are being lifted, and there have been development such as the relaxation of border restrictions on foreign tourists entering Japan from October 2022. Meanwhile, the declining trend in new infections nationwide appears to be slowing, and it is difficult to be optimistic about the situation. However, Hotel Vista Sendai is originally a property with a high occupancy rate, so the REIT's policy is to focus on the how hotel room sales trend, and also on the appropriateness of hotel management costs.

RevPAR of Hotel Vista Sendai

Source: The REIT's results briefing materials

5. Points to focus on for the external growth strategies

Based on the above-described current conditions, the REIT has established the following strategies according to the asset type. On considering that the strength of tenant needs is an important factor in ascertaining the earnings potential of real estate, it is aiming to build a highly profitable portfolio by taking comprehensive decisions by asset type for the following points. Also, going forward, the plan is for offices, retail facilities, and hotels to constitute more than 80% of the portfolio.

First, for offices, the REIT is focusing on real estate that is highly appealing for tenants. Specifically, its policy is to continue to acquire properties that satisfy a wide variety of renters' needs located in Tokyo's 8 central wards, and in the centers of Nagoya, Osaka, and Fukuoka; that are within a five minutes' walk of the nearest station; and with a rental unit price of ¥10,000 to ¥20,000 per tsubo.

Next, for retail facilities, the REIT is focusing on properties with stable tenant rent revenue and inexpensive property prices. Specifically, its plan is to acquire properties for which it can analyze the ratio of tenant rent to facilities sales, and that are relatively inexpensive compared to market prices.

For the growth strategy for hotels in the future, it intends to focus on accommodation specialized-type hotels located at transport hubs. Accommodation specialized-type hotels can be analyzed based on the sponsor's management expertise. The plan is to acquire properties in areas where demand is forecast to be strong, such as areas with excellent access to transport hubs and areas in which visitors to Japan from overseas are expected to increase. But at the current time, its policy is to focus on recovering demand for stays at hotels.

Points to focus on for the external growth strategies by asset type

Source: The REIT's results briefing materials

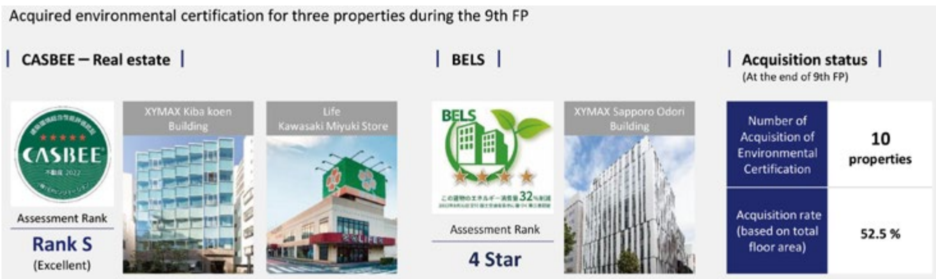
The REIT is strictly adhering to the above-described focus points according to asset type, and going forward, it will investigate property acquisitions in accordance with its portfolio strategy. Also, its policy is to continue sourcing activities to determine the fundamental value of the target properties, with an awareness of the balance between DPU growth and financial soundness. When acquiring properties, utilizing the abundant information on properties acquired through its sponsor network, the REIT carefully selects excellent properties, conducts a thorough investigation in the asset management company, and aims to accumulate new pipeline properties. Also, as the REIT's LTV level is low, it can choose to acquire properties flexibly through borrowing based on the trends in the prices of investment units. Currently, it is investigating acquiring one office (planned development) in the eight wards of Tokyo, as well as one retail facility (planned development) and one hotel (accommodation-specialized type) located in regional hub cities. The office under consideration is a property requiring construction that is owned by a client of the XYMAX Group providing CRE services in a prime location in front of a train station that is expected to enjoy strong tenant demand. The retail facility is a development project in a location that is highly desired by clients providing CRE services for opening stores. The hotel's offering information was received from a private fund management by the XYMAX Group, and the hotel is located in a regional economic hub with a high level of tourism resources and solid demand for accommodation. As of August 31, 2022, the REIT owned properties with unrealized gains worth ¥10,476mn, and it seems that it is considering returning unrealized gains to investors through asset replacement as one asset strategy.

6. Initiatives for ESG

The REIT is also working hard on ESG initiatives. In order to work on ESG organizationally and systematically, it has formulated an ESG policy and related policies along with the asset management company, built an ESG promotion system, and conducted employee training. The REIT has also participated since FY2022 in the GRESB certification system, which is an annual benchmark measuring ESG consideration in the real estate sector. It acquired "three starts" and a "green star" in the real estate evaluation, and "A level" in the disclosure evaluation. It will continue to conduct ESG initiatives going forward.

In the Environment field, among the properties it owns, eight properties have acquired certification for CASBEE (Comprehensive Assessment System for Built Environment Efficiency, a tool from the Institute for Building Environment and Energy Conservation) and three properties have acquired certification for BELS (Building house Energy efficiency Labelling System). Among three properties that newly acquired environmental certification in FY8/22, the two properties that acquired CASBEE certification (XYMAX Kiba Koen Building and Life Kawasaki Miyuki Store) received Rank S, and the one property that acquired BELS certification (XYMAX Sapporo Odori Building) received a high 4 Star assessment. The acquisition rate (based on total floor area) was also high at 52.5%. Also, as an initiative to reduce the burden on the environment, in FY2/22, it completed the switching of electric power to 100% renewable energy at eight office properties. Moreover, it has implemented environment performance improvements by renovating buildings and facilities, including installing updated air conditioners, updated LED for common areas and dedicated areas, and hydroelectric-type automated facets. Going forward as well, it plans to progress initiatives that will reduce the burden on the environment.

Status of acquisitions of environmental certification



Source: The REIT's results briefing materials

In the Social field, the REIT is advancing initiatives for tenants and local communities, including installing elevator emergency storage boxes, introducing disaster-support vendors, and implementing infection-prevention measures. In addition, as an initiative to help realize a sustainable society, XYMAX REAL ESTATE INVESTMENT ADVISORS has signed up to the 21st Century Financial Behavior Principles. Also, the sponsor's group is working to develop real estate business human resources through the Karakusa Real Estate School.

In the field of governance, the REIT establishes a decision-making process for XYMAX REAL ESTATE INVESTMENT ADVISORS for those items that will greatly affect investor profits through a committee that includes external committee members, with the aim of securing profits for investors. Other initiatives include conducting compliance education and investment by the sponsor in the REIT (the sponsor realizes an improvement of investor value by matching the REIT's ownership of investment units to investors' interests).

In recent years, ESG investment, which is investment that analyzes companies from an ESG viewpoint, has been increasing, mainly in Europe and the United States. The global ESG investment amount grew from US$18.2trn in 2014 to US$35.3trn in 2020. In Japan, ESG investment lags behind that of Europe and the United States, but by 2020 it had reached US$2.8trn and its share of the global amount has risen rapidly to 8.1%. In the context of the trend for the global expansion of ESG investment, it can be said that there remains plenty of room for it to grow in Japan as well. In this sense, the REIT's active initiatives for ESG are worthy of attention.

Benchmarking

The evaluation of investors is expected to improve alongside the strengthening of external growth

As its policy to return profits to investors, the REIT pays a high-level distribution twice a year, for each half year. In FY2/22, the distribution per unit (not including a distribution in excess of earnings) was ¥3,896, which was ¥919 above the initial forecast of ¥2,977. The REIT paid a considerably higher distribution, reflecting the strong results of significant increases in revenue and income which was partly the result of recording a gain on sale following an asset replacement that was not initially expected. Also, in FY8/22, it paid a distribution of ¥4,019, exceeding the initial forecast of ¥3,867 by ¥152. In FY8/22, the number of issued investment units increased following the initial capital increase through a public offering; however, it recorded a gain on sale of the same amount as in the previous period as planned, and leasing business revenue increased, so it increased the distribution. The REIT is forecasting a distribution of ¥3,120 (down ¥899 compared to the previous fiscal period) for FY2/23 and a distribution of ¥3,058 (down ¥62) for FY8/23. From FY2/23, the gain on sale of real estate recorded until FY8/22 will be absent, so the distribution is forecast to decrease. However, as the REIT's initial results forecasts are based on conservative assumptions, going forward, at FISCO we think that the distributions may further exceed the forecasts if the improvement of the business environment at the end of the COVID-19 pandemic is greater than expected and because of its plan to continue acquiring new properties in the future.

Looking at how price of the REIT's investment unit has trended, since August 2020, it has recovered to above the level of the TSE REIT index. Following the announcement of the resignation of Prime Minister Suga in September 2021, investors' appetite for risk strengthened as the authorities' concerns about liquidity receded. Therefore, the shift of funds to shares has progressed and as a result both the REIT and the TSE REIT index have trended bearishly overall. Moreover, since January 2022, sentiment has further worsened, including as the US Federal Reserve Board (FRB) strengthened its view that monetary tightening was urgently needed and as the situation become more tense in Ukraine, and therefore the TSE REIT has continued to trend downward. Conversely, the price of the REIT's investment unit has continued to trend upward and has greatly outperformed the market. This seems to be because investors have highly evaluated the fact that it significantly upwardly revised the distribution forecasts for FY2/22 and FY8/22. However, the issues facing the REIT include its small market capitalization and low liquidity. As of October 28, 2022, the REIT's NAV multiple (price of the investment unit / NAV per unit) was 0.85 times, which was below the average of comprehensive-type REIT of 0.98 times, and the strong sense of it being undervalued continues. Also, its distribution yield was 5.06%, significantly higher than the average of 4.36%.

As already explained, the REIT's policy going forward is to strengthen its external growth strategy through acquiring the properties it is currently investigating and consider returning unrealized gains to investors through asset replacement, and it appears distribution increases can be expected. As investors' understanding of this strategy deepens and in the situation at the current time, in which the low interest rates are expected to continue, at FISCO we think that attention will come to be focused on the REIT from it providing a distribution yield at an appealing level.

The REIT previously disclosed a medium-term target for the distribution, but currently it has stopped doing this due to the changes to its business environment, particularly the deterioration of the results of hotels due to COVID-19. However, the COVID-19 pandemic is approaching its end, so it would seem important for it to disclose targets at the stage when the results of hotels have recovered in the future in order to appeal to even more investors.

In addition, since FY8/21, the REIT has changed to an asset management remuneration system in order to contribute to improving investor profits. For management remuneration during the fiscal period, it has raised the percentage of remuneration linked to management performance, while for capital gains remuneration, it has changed to results-based remuneration that is paid only when capital gains are generated. These changes have increased the strength of the linkage between the profits of investors and the profits of the management company. At FISCO, we think this management policy that prioritizes investor profits will be highly evaluated by investors.

Comparison of the various comprehensive-type REIT indexes

Security code	Investment corporation	Investment unit price on October 28, 2022 (¥)	Investment unit price compared to previous day	Distribution yield (%)	NAV per unit (¥)	NAV multiple	Market cap. (¥mn)	Balance (unit)	Fiscal period (month)
3488	XYMAX REIT	122,100	-0.16%	5.06	144,370	0.85	30,482	497	2/8
2989	Tokaido REIT	120,800	0.42%	5.3	108,414	1.11	21,357	759	1/7
3278	Kenedix Residential Next Investment Corporation	218,700	1.11%	3.77	206,379	1.06	228,707	3,994	1/7
3279	Activia Properties Inc.	436,500	0.46%	4.27	455,695	0.96	354,684	2,443	5/11
3295	Hulic Reit, Inc.	173,700	0.52%	4.01	179,364	0.97	250,128	6,062	2/8
3296	NIPPON REIT Investment Corporation	364,000	0.83%	4.54	413,277	0.88	163,775	1,870	6/12
3309	Sekisui House Reit, Inc.	79,300	-2.22%	4.25	87,577	0.91	351,389	29,457	4/10
3451	Tosei Reit Investment Corporation	137,100	-2.21%	5.21	144,464	0.95	49,562	2,557	4/10
3462	Nomura Real Estate Master Fund, Inc.	170,200	0.89%	3.86	173,666	0.98	802,527	14,857	2/8
3468	Star Asia Investment Corporation	56,800	0.89%	5.21	55,929	1.02	109,152	6,615	1/7
3470	marimo Regional REIT, Inc	136,800	-0.22%	5.33	140,090	0.98	26,297	751	6/12
3476	MIRAI Corporation	47,150	-1.98%	5.45	50,673	0.93	83,523	22,871	4/10
3492	Takara Leben Real Estate Investment Corporation	100,300	0.20%	5.25	110,114	0.91	64,052	3,490	2/8
8953	Japan Metropolitan Fund Investment Corporation	109,400	0.46%	4.14	108,104	1.01	764,607	26,995	2/8
8954	ORIX Real Estate Corporation	199,200	0.91%	3.82	191,036	1.04	549,792	12,258	2/8
8955	Japan Prime Realty Investment Corporation	398,500	1.01%	3.85	390,909	1.02	397,375	2,788	6/12
8957	TOKYU REIT, Inc.	207,800	0.48%	3.18	204,489	1.02	203,145	3,394	1/7
8960	United Urban Investment Corporation	156,700	0.77%	3.96	161,714	0.97	488,643	11,460	5/11
8961	MORI TRUST Sogo Reit, Inc.	147,600	1.58%	4	146,299	1.01	194,832	7,207	3/9
8966	Heiwa Real Estate Co., Ltd.	151,800	0.66%	4.1	137,291	1.11	169,065	3,788	5/11
8968	Fukuoka REIT Corporation	172,300	0.88%	4.1	178,080	0.97	137,151	2,488	2/8
8977	Hankyu Hanshin REIT, Inc.	152,100	0.53%	3.93	167,692	0.91	105,740	2,020	5/11
8984	Daiwa House REIT Investment Corporation	301,000	1.07%	3.72	297,543	1.01	698,320	7,229	2/8

Source: Prepared by FISCO from the Real Estate Investment Trust Data Portal

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